

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: McClintock Analyst: LuAnna Hass Bill Number: SB 985
Related Bills: See Legislative History Telephone: 845-7478 Introduced Date: February 21, 2003
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: State Budget/Zero-Based Budgeting

SUMMARY

This bill would require budgets submitted by state agencies and courts to be based on a zero-based budget method beginning with the 2003/2004 fiscal year.

PURPOSE OF THE BILL

It appears the purpose of this bill is to formulate a better accounting system for state government.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2004 for budgets submitted for the 2003/2004 fiscal year and subsequent fiscal years.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

In order to formulate the federal budget, Congress must have a starting point. This is known as the baseline and is comprised of a set of projections showing the levels of spending and revenues that would occur for the upcoming fiscal year and beyond if existing programs and policies were continued unchanged. In the baseline, spending for all programs is adjusted so that existing levels of activity are maintained. With respect to certain type of federal programs, the baseline adjusts for, among other things, the effects of inflation and demographic changes that alter the expected number of beneficiaries. In considering proposed levels of spending and revenues, members of Congress usually describe the cost of their proposals as being above, below, or equal to the baseline.

State law requires the Department of Finance (DOF) to develop, issue, and implement consistent and adequate guidelines for state agencies to follow when submitting budgets. The guidelines must ensure that:

- the budgets are reflective of an agency's activities,
- the budgets are reflective of the costs that are associated with their execution, and
- the budgetary presentation is designed to display expenditures based on various goals or objectives when a program budget format is used.

Board Position:

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Department Director
Gerald H. Goldberg

Date
03/13/03

DOF, in cooperation with the Legislature, must develop a format for state agencies to use when developing a program budget.

Every state agency and court that receives an appropriation is required to submit a complete and detailed budget to DOF. The budget must be in the form DOF prescribes and must include all proposed expenditures and estimated revenues.

Generally, every state agency reviews their expenditure plans and prepares an annual baseline budget to maintain existing service levels. In addition, they may prepare Budget Change Proposals (BCP's) to adjust service levels. DOF analyzes the baseline budget and BCP's, estimates revenues, and prepares a balanced expenditure plan for the Governor's approval. The Governor may require state agencies, officers, or employees to furnish whatever information is deemed necessary to prepare the budget. The Governor's Budget is submitted to the Legislature by January 10th of each year. The Governor and Legislature are required to enact a budget package by June 15th of each year. After enactment the state agencies administer, manage change, and exercise oversight of the Budget on an ongoing basis. In addition, the Joint Legislative Budget Committee is involved in the ongoing administration of the Budget and reviews various requests for changes to the Budget.

See Appendix A for a general explanation of the different types of budgeting and their uses in California.

THIS BILL

As defined in this bill, "zero-based budget method" would be a budget that is calculated by beginning with a base of zero dollars and adding dollar amounts that are necessary to conduct the specific activities and operations of the state agency.

This bill would require:

- State agencies and courts for which an appropriation has been made to submit a budget using a "zero-based budget method." The zero-based budget must include:
 - each activity performed for which the agency or court requests or receives an appropriation,
 - the legal basis for performing the activity, and
 - an itemized justification for the amount requested to perform the activity.
- The budget that the Governor submits to the Legislature to be developed using zero-based budgeting (ZBB).
- Each appropriation made for spending by a state agency in the Budget Act for fiscal year 2003/2004 and all following fiscal years to be determined by each "budgetary unit" (as defined in this bill) using ZBB.
- The Budget Act to include performance standards to be applied to each state agency and a method for evaluating whether the agency met those standards.
- The Controller to prepare and publish periodic reports on the state finance process. The report would detail the changes and effects that ZBB and performance standards and evaluations have on the process.
- A task force consisting of the Director of Finance, the Controller, and Chairpersons of specific legislative committees to develop:

- guidelines and procedures to be used by state agencies to develop their zero-based budgets for the 2003/2004 fiscal year and all subsequent fiscal years, and
- a training and education program for state agency budget personnel to facilitate the development of ZBB procedures.

IMPLEMENTATION CONSIDERATIONS

This bill would require a change in the department's existing budget and revenue reporting methodology and would require retraining of existing budget staff. It is assumed that no changes in the existing state accounting system (CALSTARS) would be made and that the budget reporting requirements in this bill would be automated. Considering the above assumptions and if this bill were amended to resolve the following implementation consideration, implementing this bill would not have a significant impact on the department.

This bill would require the department to submit a budget for the 2003/2004 fiscal year that utilizes ZBB. Since this bill would be effective January 1, 2004, which would be six-months into the 2003/2004 fiscal year, the department would be unable to implement this bill as written. Department staff recommends the author consider amending this bill to begin with a later fiscal year. In addition, implementation of the ZBB requirements would rely on information that would be supplied to the department by the task force established by this bill. The department normally begins its budget process for the following fiscal year in the fall of the current year (fall 2003 for the 2004/2005 fiscal year budget). Since this bill would be effective January 1, 2004, to ensure the department receives the guidelines, procedures, and training outlined in this bill to prepare an effective zero-based budget, the author may wish to require ZBB submissions for the 2005/2006 fiscal year.

TECHNICAL CONSIDERATION

This bill would amend Government Code Section 13320 (c) to state, "As used in **the** article", which could lead to confusion regarding the article being referenced. In addition, Section 13335.5 as added to the Government Code by this bill does not define "zero-based budget method." The author may want to remove the phrase "the article" in subdivision (c) of Section 13320 and replace it with "this section and Section 13335.5." This change would clarify that the definition of "zero-based budget method" would be used for both sections of this bill.

LEGISLATIVE HISTORY

AB 499 (Canciamilla, 2003/2004) would require, for each fiscal year beginning with 2005/2006, in addition to the annual budget submitted by a state agency or court, the submission of a budget plan that contains the proposed spending and revenue for the agency or court for the following fiscal year (2007/2008). This bill has been referred to the Assembly Budget Committee.

AB 318 (Haynes, 2003/2004) would require state agencies, boards, commissions, departments, and offices to provide a report regarding financial activities to specific legislative committees for the 1998/1999, 1999/2000, 2000/2001, 2001/2002, and 2002/2003 fiscal years and for all subsequent fiscal years. This bill is with the Assembly Rules Committee.

SB 1347 (Brulte, 2001/2002) was identical to this bill and was held in the Assembly Budget Committee.

SB 1292 (Haynes, 2001/2002) would require state agencies, boards, commissions, departments, and offices to provide a report regarding financial activities to specific legislative committees for the 2001/2002 fiscal year and four preceding fiscal years. This bill was held in the Senate Appropriations Committee.

PROGRAM BACKGROUND

In the fall of each year, the department begins the following years' fiscal budget process with a base budget that is either augmented or reduced based on changes in workloads, technology enhancements, or directives from the Legislature or Administration. The department generally uses a combination of line-item and program budgeting, as defined in Appendix A. In developing the budget, the department uses a decentralized budget management structure, which requires involvement of all organizations, programs, and projects within the Franchise Tax Board.

OTHER STATES' INFORMATION

According to a report published by the National Association of State Budget Officers¹, 13 states², including California, have incorporated some aspect of ZBB or modified ZBB. In addition, most states have developed performance measures and fully incorporate those measures into the budget process. As stated in the report, 37 states collect performance information at the program level and 41 states have agencies that formally participate in performance measurement systems.

FISCAL IMPACT

Departmental information that would be required to formulate a budget based on ZBB may be available through existing internal reports. If implementing this bill were to require the department to capture additional information or require a format not currently used by the department, a new program or all-inclusive system may need to be acquired.

The impact of this bill on the department is unknown at this time. Ultimately, the potential departmental impact for the implementation of ZBB would depend on the outcome of the proposed guidelines and procedures to be developed by the task force discussed in this bill. Once the task force develops the guidelines and procedures, the department would submit a BCP for any additional resources that may be needed to ensure the department meets the guidelines.

ECONOMIC IMPACT

This bill would not impact the state's income tax revenue.

ARGUMENTS/POLICY CONCERNS

It appears ZBB could be a time-consuming process for the department and the budget analysts since it requires breaking the functions of the department down to their essential elements and then prioritizing them. This process must consider state statutes, federal requirements, court orders and decisions, and constitutional references.

¹ *Budget Processes In The States*, January 2002.

² California, Colorado, Delaware, Florida, Georgia, Iowa, Michigan, Missouri, Montana, North Dakota, Ohio, Oregon, and Virginia.

Since ZBB requires each individual agency to break down their functions to essential elements and then prioritize them, it has the potential for generating diseconomies within state agencies. For example, agency functions that are mandated could have a higher priority than non-mandated functions or personnel, such as administrative programs (budgeting, information technology, etc.), causing conflict within an agency. Likewise, state agencies could be prioritized using specific criteria, such as revenue generating agencies versus non-revenue generating agencies, which could cause conflict among agencies.

LEGISLATIVE STAFF CONTACT

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Appendix A

The following is a general description of the four basic types of budgeting and how California uses aspects of all the styles.

Line-Item Budgeting

The budget is prepared along departmental or programmatic lines and focuses on what is to be purchased with funds. Generally the budget provides a separate line-item appropriation for each major category of expenditure, such as personnel services costs, operating costs, and in some cases travel or equipment. This is the most widely accepted and best-understood technique, but does not necessarily reflect programs or services nor does it reflect performance. It is a reflection of costs to operate an agency and is as much an accounting document as it is a budget.

Uses in California: Governor's Budget (Budget Change Proposals (BCP's), Salaries and Wages Supplement, Summary by Object, Changes in Authorized Positions, Supplementary Schedules of OE&E), Budget Administration (position control, merit salary adjustment, Travel out-of-state, etc.), and Change Book (includes line-item data).

Program Budgeting

A program budget focuses on results of discrete programs and if the program achieved the expected results. An agency defines its functions or programs and applies goals, objectives, and strategies to measure performance. This process focuses on what an agency does and why, as opposed to how it does it. The emphasis is on program performance and ultimate outcomes, as opposed to inputs and processes.

Uses in California: Budget Bill, Governor's Budget (BCP's, Summary of Program Requirements, Program Objectives Statement, Program Detail), and Change Book (includes line-item data).

Zero-Based Budgeting (ZBB)

ZBB is a process designed to analyze an agency, program, or department to determine its worth and value to the government and its citizens. ZBB can take many forms, but in its purest form, this process assumes the agency does not exist and builds its programs, operations, and budget from zero to its optimum level. The agency is forced to rank their organizational purposes and programs with a focus on the priorities of and alternatives to the entity's operations.

Uses in California: Used selectively.

Performance Budgeting

A performance budget lists what each administrative unit is trying to accomplish, the planning, and the resources. It reports on how well it did with the prior year's resources. Similar to program budgeting, the emphasis is on getting the most service for the dollar. Unlike program budgeting, the

emphasis is on outputs and outcomes as opposed to mission statements, goals, and objectives. It is a system that promotes accountability.

Uses in California: Governor's Budget and measures and outputs in BCP's.